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# **Deepening Divides in the U.S. Economy, 2004: Jobless Recovery and the Return of Fiscal Deficits**

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**Deepening Divides in the U.S. Economy, 2004:  
Jobless Recovery and the Return of Fiscal Deficits**

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Since the middle 1970s—that is for more than a full generation now—the U.S. economy has been on a downward trajectory with respect to the things that matter for most people: decent jobs, access to high quality and affordable education and health care, and some reasonable level of security in terms of employment, income, and retirement. This downward trajectory became emphatically clear during the Presidency of Ronald Reagan from 1981-88, and continued through the Republican administration of George Bush -1 and the Democratic administration of Bill Clinton. Conditions have only worsened from 2001-04, with George Bush 2 as President and the Republican Party controlling both houses of Congress.

Historical forces beyond the control of any given politician or political party have certainly been important in contributing to this trend. The primary one has been the rapid pace of global economic integration. This has increasingly placed U.S. working people in competition for jobs with workers in other countries. To invoke Karl Marx’s famous term, globalization has meant a vast expansion in the so-called “reserve army of labor.” U.S. workers now compete increasingly in this global job pool with people in poor countries who are willing to work at a pay scales far below what constitutes anything close to a minimally decent “living wage” within the U.S. Of course, from the narrow standpoint of business, this pressure on U.S. workers to lower their wage demands is most frequently construed as a positive development.

But even given the contemporary realities of globalization, there is still nothing inevitable about the U.S. economy’s negative trajectory. All of the factors making economic circumstances more difficult for working people and the poor are matters that could be addressed through public policy initiatives—through government programs to, first and foremost, promote the expansion of decent jobs within the United States; and, along with this, the strengthening of social protections in the form of health care, education, and the regulation of labor and financial markets. For the most part, however, the dominant concerns of public policy have not been targeted at reversing these negative trends. Rather, the ascendancy of what are broadly termed “neoliberal economic

policies”—including the deregulation of labor and financial markets, cutting back on social expenditures as a share of the economy; and a macroeconomic policy bias supporting low inflation over the expansion of decent jobs—has only worsened the long-term negative trends.<sup>1</sup>

Writing in March 2004, two manifestations of the current conditions have become most prominent, having become, in fact, major news stories on an almost daily basis as we move deeply into the Presidential election season. The first is the so called “jobless recovery” from the 2001 recession, and the second is the return to large fiscal deficits by the federal government. In what follows, I wish to consider both of these developments, showing how they both reflect and reinforce the economy’s negative trajectory, though not primarily for the reasons that have been most prominently cited in mainstream discussions of these topics.

In focusing on these two issues, I do not mean to suggest that they are the only two major concerns in the current U.S. economic landscape. Certainly other major developments deserve similar levels of attention. One is the continuing trade deficit—i.e. that we are importing far more than we are exporting—and the fact that, as a result of this trade deficit, foreigners have built up formidable holdings of U.S. dollar assets. A second is the deepening fragility in our financial and housing markets, which is creating vulnerabilities that could lead to another market collapse comparable to the bursting stock market bubble in 2000 and 2001. However, for now, we focus on the jobless recovery and the federal deficit. These are the most visible signs of where the U.S. economy is heading, unless a dramatic shift occurs in the policy environment away from the neoliberal priorities that still define the parameters of mainstream political debate.

### **Jobless Recovery**

The single most pressing issue in the U.S. economy is the so-called jobless recovery out of the 2001 recession. The basic facts are straightforward, and I present them in summary form in Table 1. According to the official estimate of the National Bureau of Economic Research, the

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<sup>1</sup> These themes are examined at length in my 2003 book *Contours of Descent*. Except as noted otherwise, the data references in this paper taken from this book.

U.S. economy went into a recession in March 2001 and the recession ended the following November. As of this writing, that means that the U.S. has experienced 27 months, or nine full quarters, of economic recovery since the bottom of the recession in November 2001.

Table 1 compares the patterns of GDP growth and employment growth during the current recovery relative to the average experience of the previous nine recoveries, beginning with the 1949 (fourth quarter) recovery and onward to the 1991 (first quarter) recovery. As the table shows, during the previous nine recoveries, GDP grew at an average (annualized) rate of 4.3 percent for the first nine quarters from the point at which the recovery began. Employment did not grow nearly that quickly during these previous nine recessions, but still expanded at an average rate of 1.8 percent.

In the second row of data in Table 1, we see the patterns during the current recovery. GDP growth in the current recovery is 3.4 percent, which is clearly slower than the average for the previous recoveries, but still strongly positive. However, employment growth in this current recovery is actually a negative 0.1 percent during the current recovery. This means that for more than two years into *the recovery* from the 2001 recession, the U.S. economy has not produced any net increase in jobs. For those not trained in the arcanum of economics terminology, it would be reasonable to expect as something of a truism that jobs are supposed to become more scarce in *recessions*, but more plentiful in recoveries. For the first time since 1949, this normal pattern is not occurring.

#### Why the Jobless Recovery?

In the intense discussions that have occurred in the U.S. media about the jobless recovery, the so-called “outsourcing” of jobs by multinational firms has been singled out as the primary culprit. Outsourcing refers to U.S. companies transferring parts of their operations to foreign countries, where they can hire workers at wages much lower than what they would have to pay in the U.S. Perhaps the single most widely cited example of such outsourcing operations has been the telephone call centers that have been established in India, in particular in the city of

Bangalore. The women phone operators in Bangalore handle the same sorts of telephone business transactions with U.S. business customers as operators who are physically located within the U.S., and are even trained to speak English with U.S. customers in U.S.-sounding accents. The pay scale for the Indian phone operators range, on average, between one-fifth and one-tenth the already low wages earned by workers performing the same tasks in the U.S.<sup>2</sup>

Outsourcing has been an important factor in transferring jobs out of the U.S. labor market. But the available evidence suggests that outsourcing has not been growing at so rapid a rate since the beginning of the recovery in November 2001 as to be the only, or even necessarily the primary, factor behind the jobless recovery. At least as significant factor within the recovery has been the rapid increase in productivity.<sup>3</sup> An increase in productivity means that businesses are able to produce a given amount of goods and services with a smaller staff of employees. During the current recovery, productivity has been rising, on average, at an annual rate of 5.1 percent. This compares with a 3.1 percent average productivity growth rate during the previous business cycle recoveries since 1949, considering only the first nine quarters of recovery. Moreover, the 5.1 percent productivity growth rate for this recovery is faster than any previous recovery since the 1949 recovery.

What would be the impact on job growth in this recovery if productivity were growing only at the average 3.1 rate rather the actual 5.1 rate? As a rough estimate, for the economy to keep growing at its actual 3.4 percent growth rate during this recovery, that would mean, an additional 1.7 million workers would have been hired during the recovery if productivity were growing at 3.1 percent rather than the actual 5.1 percent rate. If these additional 1.7 million jobs

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<sup>2</sup> See, for example, the discussion of the Bangalore call centers in the *Fortune* cover story by Fox (2003).

<sup>3</sup> The Business Week cover story by Nussbaum (2004) emphasizes that productivity growth has been a far more significant factor than outsourcing in contributing to the jobless recovery. However Gordon (2004) demonstrates the technical difficulties of separating out statistically the distinct effects of productivity and outsourcing to poor countries. Gordon summarizes his basic point succinctly: "The one-sentence explanation is that in measuring productivity growth, the practice is to ignore the fact that imports from third world countries are at prices far less than the prices that prevail in first world countries, at least in the United States."

had indeed been created, there would be no jobless recovery at all, but rather a positive, if slow, expansion of hiring, at a 0.6 percent rate.<sup>4</sup>

Should we consider this rise in productivity as a benign phenomenon—as a sign of the growing efficiency of business operations, with perhaps the temporary side effect of a slower growth of job opportunities? This has been the primary sentiment expressed in the mainstream media, which attributes the rise in productivity growth to the benefits generated by businesses using computers and other information technologies with greater and greater effectiveness. But even if it were true that technology is the primary driver of productivity growth, this is no guarantee that working people would benefit from these new technologies. This becomes clear in observing the experience in the U.S. between 1973-93, when productivity rose by 36 percent while the average real wage still *fell* by 15 percent.<sup>5</sup>

Nevertheless, technology is by no means the whole explanation behind the rapid rise in productivity. Other factors have also been crucial. One is worker speed-up—i.e. pushing workers on the job harder without providing extra pay, i.e. a decidedly old-fashioned, low-tech source of productivity growth. In May 2002, Business Week reported that white collar workers felt that the productivity gains “have come on their backs....They complain about managing the orphaned workloads of downsized colleagues, scouring new avenues for business, and fighting for high-profile posts so that if the ax falls, it won’t hit them.” The same Business Week story described how major corporations, including Wal-Mart, Taco Bell, Starbucks, and U-Haul, were

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<sup>4</sup> The basis for this rough estimate is very simple. The actual GDP growth rate for the nine quarters of recovery since 2001.4 is 3.4 percent. If we assume that productivity were growing in this period at 3.1 percent instead of the actual 5.1 percent rate, that would mean that, to achieve a GDP growth rate of 3.4 percent, employment would need to grow, on average, at 0.3 percent (as an annualized rate). I thus increased the actual employment figure for 2001.4 by 0.3 percent, and compound this same effect for each quarter of the recovery through 2003.4. This technique makes several strong assumptions in the name of simplicity: that productivity in the public sector equals that of the private sector; that working hours remain constant; and that, in the face of a slower productivity growth rate, businesses would nevertheless spend enough to support a 3.4 percent GDP growth rate. Even recognizing these strong assumptions, I nevertheless hold that this technique provides a roughly accurate estimate of the effects of productivity growth on employment during the current recovery. I acknowledge the collaboration of Prof. James Heintz in formulating this estimation technique.

<sup>5</sup> See Pollin (2003) op. cit., pp. 43 – 45.

forcing their production-level employees to work extra hours without receiving overtime pay (and being hit with class-action lawsuits as a result).<sup>6</sup>

Another important factor has been the fiscal crisis of state and local governments. Over 2002 – 2003, state and local government were experiencing their most severe budgetary crisis since World War II. Thus, in fiscal 2002, 17 states had cut health care programs, 10 had cut income support or employment support programs, and 17 had cut other social service programs. Conditions deteriorated further in fiscal year 2003, with fourteen states cutting spending on secondary education, and twenty states cutting budgets for college and universities.<sup>7</sup>

Putting aside the effects of these cuts on the provision of basic services (to which I return below), the impact of these cuts have also been highly damaging in terms of jobs, especially given the spending increases that were also occurring to wage war in Afghanistan and Iraq. This is because employment in education and health care are the biggest areas of public sector employment. Moreover, spending on education in particular, relative to all other potential areas of spending, including consumer goods, private business investment, and federal government spending in general, has the largest positive impact on job creation for a given dollar of expenditure. To consider one important comparison, a million dollars spent on education will produce roughly twice as many jobs as the same funds spent on the military. Spending on health care is not as effective as education in producing jobs, but it still generates roughly 50 percent more employment for a given level of expenditure than the military.<sup>8</sup>

These figures on public spending and employment emphasize a crucial broader point: The jobless recovery is not simply a result of outsourcing or productivity, though these are both obviously central. The fact is that the Bush administration has done nothing to counter these factors which depress job opportunities by advancing initiatives to expand jobs elsewhere, such as in the educational sector.

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<sup>6</sup> See Conlin (2002).

<sup>7</sup> See Pollin (2003) *op. cit.*, pp. 104-08.

<sup>8</sup> These estimates are based on Medoff (1993).



### **The Return of Fiscal Deficits<sup>9</sup>**

The Clinton administration was unequivocal in citing the reversal of the government's fiscal stance, and in particular the achievement of three straight years of fiscal surpluses during 1998 – 2000 as its most important policy achievement. The U.S. government had not previously run surpluses for three straight years since the Harry Truman administration in 1947 – 49.

During the 2000 election, both Bush and Gore were projecting surpluses into the indefinite future. The basic debate between them was how best to distribute the largesse. All such talk evaporated quickly under Bush. In 2001, the surplus fell from \$236 to \$127 billion, and by 2002, the government was again running a deficit of \$158 billion. By 2004, the deficit had ballooned to \$477 billion. Even the Republican-controlled Congressional Budget Office currently projects persistent deficits at least through the end of the decade.

This fiscal situation under Bush is indeed a disaster. However, the most important reasons this is true are not what the deficit hawks claim. The overarching problem usually cited about the fiscal deficit is, simply, that it exists and that it is large. This is the view most prominently associated with Clinton Democrats such as Robert Rubin, who was Clinton's closest economic advisor and Treasury Secretary for a time. "Rubinomics" is the term generally associated with this view. Of course, Republican economists, including the current Chair of the Council of Economic Advisors N. Gregory Mankiw, held basically the same position in their published writings before they took on the job of defending the Bush deficits.<sup>10</sup>

The deficits for 2003 and 2004 certainly were large, at 4.2 and 4.3 percent of GDP. But these figures are far from unprecedented. The deficit was 4.7 percent of GDP coming out of the 1991-92 recession under Bush 1, and was 6.0 percent of GDP in 1983, coming out of the 1982 recession under Reagan. Indeed, Reagan ran for re-election in 1984 under the slogan "Morning

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<sup>9</sup> This discussion mainly follows that in Pollin (2003), pp. 108 – 115.

<sup>10</sup> Both the Rubin and Mankiw positions are presented in Rubin, Orzag and Sinai (2004).

in America.” Obviously, the Reagan Republicans were not particularly exercised about the outsized deficits of that period.

The real issue with the deficits is not their size alone, but rather why they have emerged and the purposes they are serving. On this score, it must first be emphasized, that neither fiscal deficits nor fiscal surpluses are inherently good or bad. Thus, the primary factor generating the \$250 surplus in 2000 under Clinton was that, since 1991, the government had frozen its spending levels on its discretionary programs (exclusive most prominently of Social Security and Medicare, where spending commitments have been mandated), so that the size of these programs actually fell relative to the size of the economy as the economy grew over time. Thus, for example, spending on education had fallen by 24 percent relative to GDP between 1992 and 2000, i.e. from when Bush 1 left office to the end of the Clinton era. In evaluating the attainment of surplus, shouldn't we also take account of the costs incurred, including, as just one example, fewer teachers, fewer scholarships for needy students, and less new construction on educational facilities?

As a second consideration, a major factor in producing the first Bush deficit in 2002 was the 2001 recession. Running a fiscal deficit during the recession was a positive benefit. It directly injected about 4 percent more spending into the economy than would have occurred if the government would have remained committed to maintaining a surplus at its 2000 level. The recession would no doubt have been far more severe had the government maintained the commitment to fiscal surpluses to which both Bush and Gore had committed themselves during the 2000 campaign.

In short, the Clinton surpluses imposed significant social costs and the 2002 deficits helped counteract the recession: again, neither deficits nor surpluses are inherently good or bad. Nevertheless, it is still the case that the Bush deficits, especially from 2003 onward, have little to recommend them. They are continuing to provide some short-term stimulus to the economy

during the jobless recovery. However, the stimulus is being achieved in a manner that is both highly inefficient and unfair.

It is important to recall here that Bush ran for office and came into the Presidency with a single-minded economic policy agenda, which was to cut taxes for the rich. Bush has maintained his single-minded commitment to this overarching purpose, despite the recession, the September 11 the terrorist attacks and national emergency, and the wars in Afghanistan and Iraq. As a candidate, Bush argued for tax cuts, benefiting primarily the wealthy, on, of all things, grounds of fairness—amid the still booming economy, talk about tax cuts as a means of fighting a recession were of course non-existent. When signs of a recession emerged just as Bush was taking office in January 2001, he recycled his same tax-cutting proposals, but now he had construed these proposals as not simply a means of treating our most affluent taxpayers fairly, but as also the most effective possible tool available for fighting the recession. It did not seem to matter to Bush that in his initial January 2001 tax proposal, *none* of the tax cuts were to occur in 2001 itself—that is, in the year the recession was occurring. The key point with Bush, tax cuts, and the deficit is clear: his real aim all along has been to make the rich richer, despite the fact that income and wealth distribution in the U.S. had continued to become increasingly unequal under Clinton, as well as, previously, under Reagan and Bush 1.

The other major factor driving the deficits is the costs of war in Afghanistan and most recently Iraq. Put aside the fact that these were both unjust wars that have only contributed to increasing rather than reducing the threat of terrorism. Simply as a means of stimulating the economy and the growth of jobs, a stimulus based on expanding the military his highly inefficient, as I have discussed above.

But there is a still more serious problem with the Bush deficits: they are creating mounting pressures for a permanent contraction in social spending by the federal government. The Nobel Laureate in Economics and right-wing economics guru Milton Friedman could not have been more blunt on this point, explaining that deficits serve as “an effective—I would go so

far as to say the only effective—restraint on the government propensities of the executive branch and the legislature.”<sup>11</sup> Federal Reserve Chair Alan Greenspan himself demonstrated Friedman’s point emphatically, when, in February 2004, he stated that Social Security benefits would have to be scaled back in light of the ongoing fiscal crisis (*New York Times* 2/26/04 p. A1). Greenspan did not mention then that he himself had endorsed the Bush tax cuts in 2001, providing an aura of legitimacy to the very Bush program which is responsible for the long-term deficit projections.

To date, we see the results of the Bush program to simultaneously cut taxes for the rich, increase the fiscal deficit, and reduce social spending through the fiscal crisis of the state and local governments. Why couldn’t the federal governments prevent these cuts through increasing its so-called “revenue sharing” support for state and local governments? The reason advanced, of course, is the same as that given by Greenspan on Social Security: the presence of fiscal deficits makes it impossible for the federal government to increase support for spending on health, education and public safety, i.e. the basic services provided by state and local governments. This is the path through which scaling back funds for basic social needs like health and education become enshrined as permanent features of the developing economic landscape.

Alternative paths are possible. The federal government can itself be mobilized as a powerful tool to promoting jobs and social welfare. Other policy tools can also be effectively utilized toward this end, including Federal Reserve interventions and measures to regulate financial and labor markets in behalf of both greater efficiency and fairness. But the fact is that economic conditions for the vast majority of U.S. citizens will not improve until there is a dramatic reversal in the country’s policy priorities. To be specific with respect to the topics examined in this paper: without such a reversal in policy priorities, there will continue to be a growing scarcity in the availability of decent jobs in the U.S., and the federal budget will continue to act a tool for delivering largesse to the already overprivileged.

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<sup>11</sup> See Friedman (2003).

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## Economic Growth and Employment Growth During Recoveries from Recessions

*Growth Figures are for 9 Quarters from the Troughs of Recessions*

	<i><b>GDP Growth</b></i>	<i><b>Employment Growth</b></i>
<b>Nine Recoveries From Recessions between 1949 (first quarter) and 1993 (first quarter)</b>	+4.3%	+1.8%
<b>Recovery from 2001 Recession: 2001 (fourth quarter) to 2003 (fourth quarter)</b>	+3.4%	-0.1%

Source: U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics